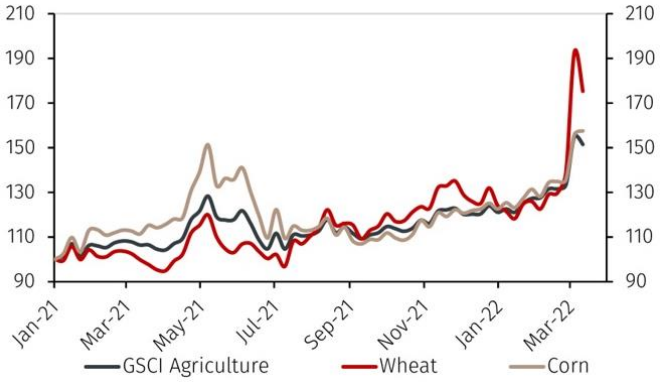
20th April 2022

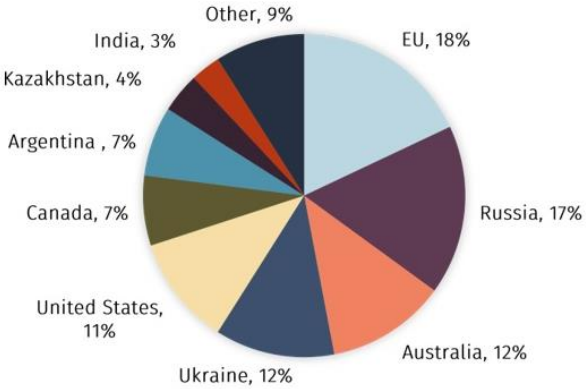
Global equity perspectives

Russia / Ukraine Crisis and its effect on commodities

The Ukrainian war has had major implications for capital markets, considering the effects on commodity prices, inflation and economic activity in affected areas. As 2 of the largest global producers of agricultural commodities, including wheat, maize and oilseeds, Russia's invasion of Ukraine has been a major shock to global agricultural commodity prices.

**Agriculture commodity prices & Wheat export split*





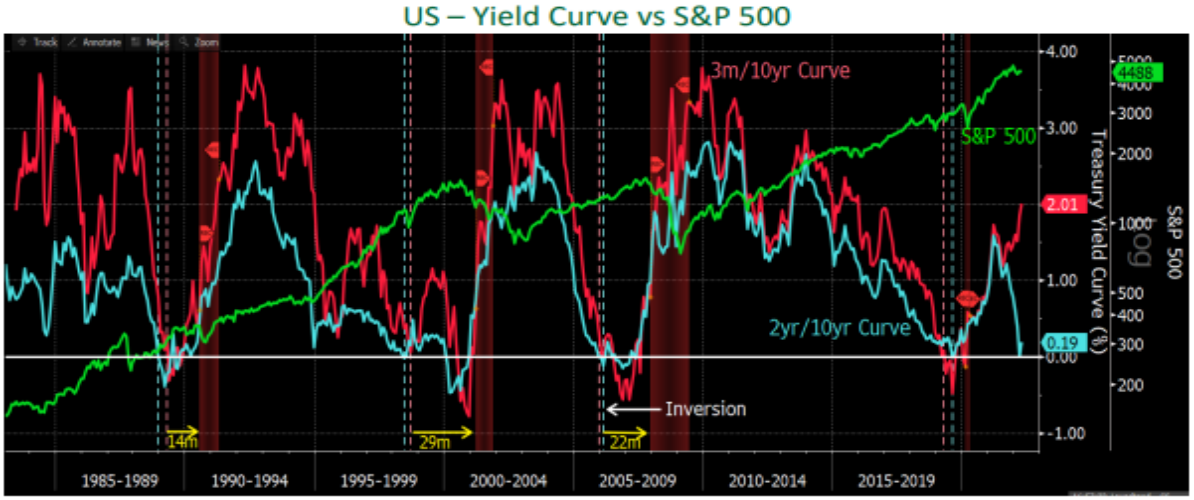
The war's battlefields overlap with some of the globe's most important cropland. Protracted fighting in Ukraine has already interrupted the annual cycle of sowing and reaping on Ukrainian farms. This is likely to disrupting the global trade in food beyond the end of 2022.

The United Nations' Food and Agriculture Organization last week cut its forecast for global cereals trade to 469 million tons, down 14.6 million tons from its March estimate, citing the interruption of exports from Ukraine and Russia. Lower trade volumes will crimp food imports across much of the Middle East and North Africa, raising concerns over hunger and political instability.

Email: roscoecj@rockmancap.com | http://rockmancap.com | Telephone: + 230 214 2251
3 River Court, St Denis Street, Port Louis, Mauritius

The Treasury Spread

As an investment house, Rockman Capital closely monitors the spread between the 2/10-year US treasury yields. Last week we witnessed the 10-year/2-year treasury curve invert, producing the first negative spread since 2008. It has since turned positive. This is an early signal of an approaching recession.

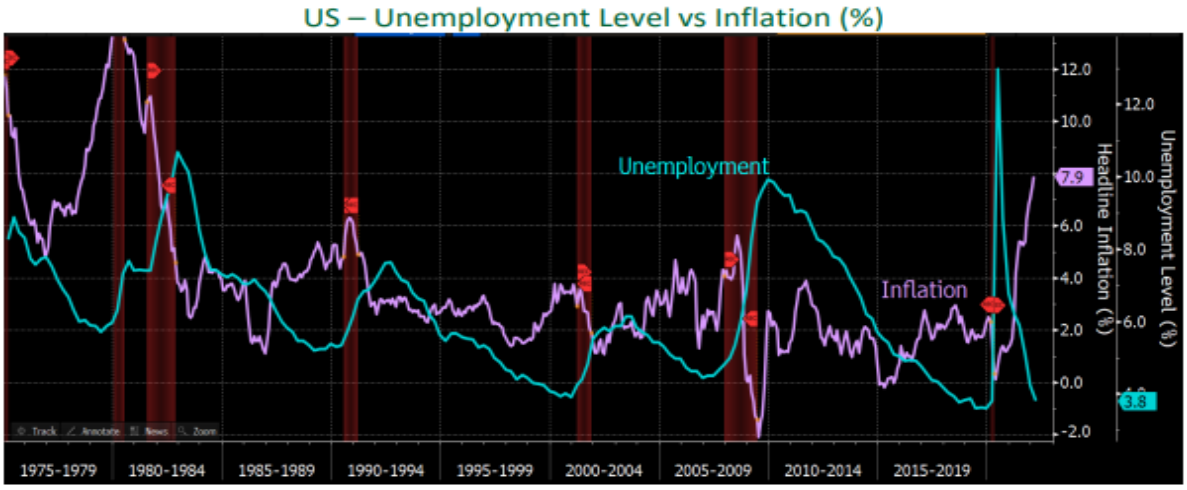


In the past 40 years, the inversion of the 10/2-year curve has preceded and 10 of the last 13 recessions.

Per David Kelly, chief strategist at JPMorgan Asset Management:

> *An inverted yield curve doesn't do much to the economy, but it's a very bad sign. The only reason you'd buy a long-term bond at a lower yield than a short-term one was if you thought yields were going to fall . . . this usually happens when most people think the Fed has gone too far or will go too far. That's the classic "Fed mistake".*

US unemployment is currently at a historically low level of 3.8%. As the economy is out of workers and with the US Federal Reserve pushing rates higher, a slow-down in economic activity risks bringing on a recession. The combination of full employment and high inflation (Inflation is presently running at a forty year high of 7.9%), does not sit easy with investors.



Bank of America technical analyst, Stephen Suttmeier, summarizes how a recession plays out following the inversion of the 2/10-year spread:

> *While the lead times vary and can be long, the typical pattern is that (once) the 2s/10s yield curve inverts, the S&P 500 tops sometime after the curve inverts and the US economy goes into recession six to seven months after the S&P 500 peaks. . . post-inversion dips and last gasp rallies for the S&P 500 . . . often occur prior to the deeper recession-linked market corrections.*

Around the time of curve inversions, as highlighted by the table below, sectors performance varies:

Sector Performance Before & After Yield Curve Inversion

Sector	-12Mos	-6Mos	-3Mos (sorted)	+3Mos	+6Mos	+12Mos
TECH	32.5%	19.5%	12.0%	-2.4%	4.0%	3.4%
UTL	13.3%	2.5%	6.0%	5.4%	14.3%	20.7%
S&P 500	12.8%	12.6%	5.8%	3.2%	6.9%	8.2%
IND	4.4%	1.3%	1.5%	9.6%	7.4%	11.6%
CD	1.7%	4.4%	1.3%	2.4%	-1.6%	15.8%
MAT	0.4%	2.0%	0.8%	4.4%	-2.2%	13.8%
COMM	7.2%	6.8%	0.0%	-0.3%	-0.5%	8.8%
ENE	4.0%	-5.9%	-1.0%	9.8%	4.2%	-0.3%
HC	-2.3%	-2.7%	-1.0%	8.1%	9.8%	20.4%
FIN	-1.1%	1.3%	-2.7%	12.0%	14.3%	14.8%
CS	-1.6%	-1.7%	-2.8%	5.3%	5.5%	19.1%

- Tech leads heading into an inversion.
- Classic defensives such as utilities, healthcare and consumer staples do well afterwards, as investors gird for what is to come.

When the recession does eventually hit, the S&P 500 will experience a significant drop: It is calculated that during the average recession, the S&P 500 drops by a third over 13 months — enough to make anyone think twice about hanging on for that last bounce after the curve inverts.

Every time the 10/2 curve inverts, market participants come out with a long list of reasons why the curve's slope tells us little about the current environment and should have no correlation with a recession. We all know what happens subsequently: For the past half century or so, what happens subsequently is a recession.

As mentioned in previous correspondence (refer *War in Europe – Global Implications*), Rockman Capital's portfolios continue to be defensively positioned. We:

- Remain in favour of equities in the short-term.
- Continue to focus our investments on defensive, low Beta, and consistent dividend yielding stocks.
- Have Increased weightings in Utilities, Consumer Discretionary, Staples, and Cyclicals.
- Remain negative in fixed income and corporate debt, specifically US Treasuries.
- Continue to increase cash holdings during this time of market volatility.